

## Message Text

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ACTION EA-13

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INFO AMCONSUL HONG KONG

C O N F I D E N T I A L PEKING 1559

LIMDIS

E.O. 11652: GDS

TAGS: EMIN ETRD BDIS EEWT CH US

SUBJECT: CONTROLS ON STEEL SCRAP EXPORTS TO THE PRC

REF: STATE 196158

SUMMARY: DESPITE PRCLO PROTESTATIONS TO THE CONTRARY, WE BELIEVE THE CHINESE ARE IN NEED OF STEEL SCRAP OR THEY WOULD NOT HAVE RAISED THE MATTER OF UNFULFILLED CONTRACTS WITH THE DEPARTMENT ONCE AGAIN. THIS MESSAGE PUTS FORTH A POSSIBLE AVENUE OF APPROACH THAT WOULD NOT INVOLVE MAJOR CONCESSIONS BY THE US BUT WHICH MIGHT LEAD US OUT OF THE CURRENT IMPASSE. END SUMMARY.

1. WE HAVE THE FOLLOWING THOUGHTS ON CONVERSATION REPORTED REFTEL. FIRST, NOTWITHSTANDING CHANG'S PROTESTATION THAT NON-DELIVERY OF 400,000 TONS DID NOT WORK GREAT HARDSHIP ON PRC, WE SUSPECT THE CHINESE NOW NEED MORE SCRAP AND THAT THIS IS THE MAJOR REASON FOR REOPENING THE MATTER AT THIS TIME. WE BELIEVE PRC IRON AND STEEL OUTPUT IN FIRST HALF OF 1974 FELL SHORT OF PRODUCTION GOALS. AS FAR AS WE AWARE, THE CHINESE HAVE NOT BEEN ABLE TO OBTAIN SIGNIFICANT QUANTITIES FROM OTHER SOURCES AND THEIR  
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SUPPLIES OF SCRAP, DUE PRINCIPALLY TO LARGE PURCHASES

FROM THE US LAST YEAR, ARE PROBABLY DRAWN DOWN. AS THE DEPARTMENT WILL RECALL, MINMETALS OFFICIALS HERE WERE MOST RELUCTANT EARLIER THIS YEAR TO PROVIDE USLO WITH ANY HARD EVIDENCE OF SPECIAL NEED OR HARDSHIP. WE ATTRIBUTE THIS MOSTLY TO CONSIDERATIONS OF "FACE" AND THE RELUCTANCE FOR A COUNTRY WHICH PUTS A HIGH PREMIUM ON SELF-RELIANCE TO ADMIT DEPENDENCE ON A FOREIGN SOURCE OF SUPPLY.

2. OUR SECOND THOUGHT IS THAT IT WOULD BE UNCHARACTERISTIC OF THE CHINESE TO INSIST THAT THE AMERICAN FIRMS CONCERNED FULFILL IN EVERY DETAIL CONTRACTS WHICH THEY HAD SIGNED EARLIER AND WERE UNABLE, FOR REASONS BEYOND THEIR CONTROL, TO FULFILL. WHEN DIFFICULTIES ARISE REGARDING PERFORMANCE OF CONTRACTS, THE CHINESE ARE INVARIABLY WILLING TO NEGOTIATE AN ADJUSTMENT OR A SETTLEMENT, AND EVEN WISH TO AVOID GOING TO ARBITRATION. WHATEVER THEY MAY BE TELLING THE USG, THEY CERTAINLY REALIZE THAT MARKET CONDITIONS HAVE CHANGED SIGNIFICANTLY SINCE THE SCRAP CONTRACTS IN QUESTION WERE SIGNED, AND THAT IT WOULD BE UNREALISTIC TO INSIST THAT THE FIRMS INVOLVED MAKE SHIPMENTS ACCORDING TO THE ORIGINAL TERMS.

3. THE DEPARTMENT MAY THUS WISH TO CONSIDER AN APPROACH ALONG THE FOLLOWING GENERAL LINES. FIRST, MAKE CLEAR TO PRCLO THAT THE USG IS WILLING TO BE HELPFUL WITHIN THE FRAMEWORK OF EXISTING REGULATIONS WHICH OF COURSE MUST BE OBSERVED. IF CHINA DOES NEED TO IMPORT FURTHER SCRAP FROM THE US, CONSIDERATION COULD BE GIVEN TO PROVIDING AN ADDITIONAL AMOUNT FROM THE CONTINGENCY ALLOCATION AS WAS DONE EARLIER THIS YEAR. SECOND, REITERATE TO PRCLO THAT ANY EXPORTER MAY SHARE IN A CONTINGENCY ALLOCATION INCLUDING THOSE FIRMS WHICH WERE PARTIES TO THE OUTSTANDING CONTRACTS IN QUESTION. THIRD, STATE THAT WHILE UTILIZATION OF A CONTINGENCY ALLOCATION BY ANY EXPORTER REFERS TO NEW CONTRACTS, THE USG WOULD ACCEPT AS ELIGIBLE ANY PORTION OF THE OUTSTANDING CONTRACTS UP TO THE LIMIT OF THE PRC ALLOCATION PROVIDED THAT MINMETALS HAD WORKED OUT WITH THE US EXPORTERS MUTUALLY ACCEPTABLE CONDITIONS (I.E. THE USG WOULD CONSIDER REVISED VERSIONS OF THE OLD AGREEMENTS AS NEW CONTRACTS). AT THIS POINT IN ITS DISCUSSION WITH PRCLO, CONFIDENTIAL

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THE DEPARTMENT COULD ALLUDE TO CHANGED MARKET CONDITIONS, THE FACT THAT US EXPORTERS WERE UNABLE TO MAKE SHIPMENTS FOR REASONS BEYOND THEIR CONTROL, ETC. PERHAPS THE SAME PROCEDURE MIGHT BE FOLLOWED IN SUBSEQUENT QUARTERS, UNTIL MOST OR ALL OF THE OUTSTANDING CONTRACTS HAVE BEEN IMPLEMENTED.

4. THE VIRTUE OF THIS APPROACH IS THAT WHILE THE USG MAKES NO SIGNIFICANT CONCESSION, IT WOULD FACILITATE

RESOLUTION OF THE PROBLEM OF THE UNFULFILLED CONTRACTS AND FROM THE CHINESE POINT OF VIEW PRESERVE THEIR PRINCIPLED STAND ON INVIOABILITY OF CONTRACTS. IT SHOULD ALSO, IF THE CHINESE BUY THE IDEA, ENABLE THE PRC AND THE FIRMS CONCERNED TO RESUME A NORMAL BUSINESS RELATIONSHIP. OVER THE LONG TERM AND AFTER THE CURRENT SHORTAGE OF SUPPLIES IS OVER, THE PRC COULD WELL BECOME AN IMPORTANT LONG TERM CUSTOMER FOR US SCRAP EXPORTERS.

5. THE ATTRACTIVENESS OF THE ABOVE IDEA TO THE CHINESE MIGHT BE ENHANCED BY SOME FURTHER INDICATION OF FLEXIBILITY SHOULD THEY BE WILLING TO GO ALONG. AT PRESENT, WE UNDERSTAND, ONLY EXPORTERS WITH A HISTORICAL RECORD DURING THE BASE PERIOD ARE ENTITLED TO A PRO RATA SHARE OF THE BASIC ALLOCATION. FOR THE MOST PART THESE DO NOT INCLUDE FIRMS WITH UNFULFILLED CONTRACTS WITH THE PRC. IF THE RESTRICTION ON UTILIZATION OF THE BASIC ALLOCATION COULD BE REMOVED, THIS MIGHT FACILITATE A CLEANING UP OF A SLIGHTLY LARGER PORTION OF THE OUTSTANDING CONTRACTS THAN WOULD OTHERWISE BE POSSIBLE.  
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